Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Federal-State Joint Board on	)	
Universal Service Seeks Comment	)	
On Certain of the Commission's	)	
Rules Relating to High-Cost Universal	)	
Service Support	)	

COMMENTS
of the
ORGANIZATION FOR THE PROMOTION AND ADVANCEMENT OF SMALL TELECOMMUNICATIONS COMPANIES

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SUMMARY

The existing universal service support mechanism for rural telephone companies -- based on study area average embedded costs -- is rational, accountable to the public and achieves the universal service objectives of the 1996 Act. As a result, alteration of the mechanism for rural ILECs is neither necessary nor desirable. Where reform is needed is in the portability rules for CETCs. These rules are causing limited universal service resources to be wasted and placing unnecessary strain on the High-Cost program. The Joint Board should therefore recommend that the identical support rule be immediately eliminated and that CETCs in rural service areas be transitioned to a system of support based on their own embedded costs.

The complete statutory definition of "rural telephone company" should continue to be used for determining which carriers are "rural" for high-cost universal service purposes. The statutory definition of "rural telephone company" was developed with universal service in mind and is well-suited for use in determining which carriers should be subject to a rural support mechanism. Reducing the number of ILECs deemed to be "rural" for universal service purposes fails to directly address the primary cause of growth in the High-Cost program – providing CETCs with the ILEC's per-line support.

Support for rural ILECs should remain based on their embedded costs. The use of embedded costs has been instrumental to rural ILECs' ability to deploy the infrastructure capable of providing advanced services. Without a direct link between the actual network investments made by rural ILECs and the support amounts they receive, carriers would be highly reluctant to make the upgrades necessary to provide advanced services.

A support mechanism based on FLEC estimates would not provide specific, predictable and sufficient support. It unrealistically assumes a least-cost, hyper-efficient network, failing to account for much of the cost already incurred by carriers in the build-out of their networks. Also, it has yet to be shown that a model can be developed that would consistently produce reasonable estimates of FLEC for all rural ILECs.

Support for CETCs in rural service areas should be based on their own embedded costs. There is no basis to presume that providing CETCs with the ILEC's identical per-line support provides each CETC with "sufficient," but not excessive support. When a CETC has lower costs than the ILEC, the identical support rule provides the CETC with an unfair competitive advantage. ILECs assume the full obligations of carriers of last resort, offering reliable, high-quality service to everyone in their territories. CETCs, on the other hand, have significantly fewer expectations and requirements placed on them.

CETCs are responsible for the substantial majority of the recent growth in the rural High-Cost program. It follows, then, that the way to directly address the growth in the Fund is to abolish the identical support rule and move toward basing support for CETCs on their own costs.

The Joint Board and/or FCC should hold industry workshops to develop the accounting mechanisms through which CETCs in rural service areas would be required to report their embedded costs. There should be cost reporting parity between ILECs and CETCs. During the period of time in which accounting rules are being developed, the FCC should adopt the interim plan filed by the Rural Telecommunications Associations in the proceeding on the Joint Board's Portability Recommended Decision. Under this

plan, wireless CETCs would receive a "safe harbor" percentage of the rural ILEC's per-line support, with the specific percentage determined by the size of the wireless carrier.

The existing support calculation methodology for rural ILECs should be maintained. Most importantly, the FCC should continue to calculate high-cost support for rural carriers based on individual carriers' study area average costs. The use of study area average costs provides the appropriate incentives for the network investment needed to provide the supported services. The High-Cost program is designed to support networks, not lines. Thus, higher per-line support is necessary when line counts decrease in order to maintain sufficient support for the maintenance and upgrading of the network.

The calculation of support based on statewide average costs would be extremely detrimental to rural service areas, denying carriers sufficient support to provide quality service at affordable rates. The Rural Task Force found that 37 states and territories which presently receive universal service support for rural carriers would see their support eliminated if statewide averaging were adopted. Unlike the non-rural carriers, rural telephone companies do not have low-cost metropolitan cores that they can use to offset the high cost of their sparsely populated territories.

The existing LSS mechanism works well and should remain in place. Even though eligibility for LSS is determined by an ILEC's number of lines in service, the mechanism is still responsive to costs. Small rural LECs will continue to have higher switching costs on a per-subscriber basis than large, urban carriers.

Finally, the Joint Board should consider the potential outcomes of other interreleated proceedings before recommending any changes to the support mechanism

for rural ILECs. This includes the open proceedings on intercarrier compensation reform and reform of the USF contribution methodology.

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I. INTRODUCTION

The Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO) hereby submits these comments in response to the Federal-State Joint Board on Universal Service's (Joint Board) Public Notice, released August 16, 2004.[1] The Public Notice seeks comment on issues relating to the high-cost universal service support mechanisms for rural carriers and the appropriate rural mechanism to succeed the five-year plan adopted in the Federal Communication Commission's (FCC, Commission) Rural Task Force Order.[2]

[1] *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45, Public Notice, FCC 04J-2 (rel. Aug. 16, 2004) (Public Notice).
[2] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers*, CC Docket No. 00-256, Report and Order, 16 FCC Rcd 11244 (2001) (Rural Task Force Order).

OPASTCO is a national trade association representing over 560 small incumbent local exchange carriers (ILECs) serving rural areas of the United States. Its members, which include both commercial companies and cooperatives, together serve more than 3.5 million customers. All OPASTCO members are rural telephone companies as defined in 47 U.S.C. §153(37). OPASTCO members offer a wide array of communications services to rural consumers in addition to the traditional telephone services they provide as ILECs. These include dial-up Internet access, high-speed and advanced services, mobile wireless services, competitive local exchange service, long distance resale, and video services.

As the Joint Board considers the recommendations it will make in this proceeding, it must focus on ensuring that the statutory goals for universal service contained in Section 254 of the Telecommunications Act of 1996 (1996 Act, the Act) are met. In particular, and as the Joint Board acknowledges,[3] support mechanisms should be specific, predictable and sufficient;[4] and consumers in all regions should have access to telecommunications and information services, including advanced services, that are reasonably comparable to those provided in urban areas and at reasonably comparable rates.[5] In addition to the principles mentioned in the Public Notice, Congress also established that quality services should be available at just, reasonable and affordable rates;[6] and access to advanced telecommunications and information services should be provided to all regions of the nation.[7]

[3] Public Notice, ¶2.
[4] 47 U.S.C. §254(b)(5).
[5] 47 U.S.C. §254(b)(3).
[6] 47 U.S.C. §254(b)(1).
[7] 47 U.S.C. §254(b)(2).

For rural telephone companies, the existing universal service support mechanism -- based on study area average embedded costs -- is rational, accountable to the public and effectively achieves the Act's universal service objectives. Consequently, alteration of the mechanism for these carriers is neither necessary nor desirable. However, where reform is desperately needed is in the portability rules for competitive eligible telecommunications carriers (CETCs) in rural service areas. These rules are causing limited universal service resources to be wasted at ratepayers' expense and placing significant strain on the High-Cost program. These rules are also not competitively neutral. The Joint Board should therefore recommend that the identical support rule be immediately eliminated and that CETCs in rural service areas be transitioned to a system of support based on their own embedded costs. This would introduce the same rationality and accountability in the support system for CETCs that already exists for rural ILECs. In addition, it would enable all ETCs to receive sufficient, but not excessive support, as called for by the Act.

II. THE JOINT BOARD SHOULD NOT ATTEMPT TO ALTER A SUPPORT MECHANISM FOR RURAL ILECS THAT IS ALREADY RATIONAL, ACCOUNTABLE AND ACHIEVING THE GOALS OF SECTION 254; INSTEAD IT SHOULD FOCUS ON BASING SUPPORT FOR CETCS ON THEIR OWN COSTS

A. The complete statutory definition of "rural telephone company" should continue to be used for determining which carriers are "rural" for high-cost universal service purposes

The Joint Board should recommend that the complete statutory definition of "rural telephone company"[8] continue to be used for the purpose of determining which carriers are subject to the rural high-cost support mechanism. Congress established the rural telephone company definition to provide the basis for distinguishing carriers that are

[8] 47 U.S.C. §153(37).

different from non-rural carriers. The four criteria in the rural telephone company definition relate to two basic conditions that challenge rural carriers and contribute to their higher costs – low density (criteria A and D) and small customer base (criteria B and C). The Joint Board should not attempt to second-guess Congress regarding what constitutes "rural" by eliminating certain criteria.

The language of the 1996 Act demonstrates that the definition of "rural telephone company" was developed with universal service in mind and is well-suited for use in determining which carriers should be subject to a rural support mechanism. For instance, the purpose of Section 214(e) is to set the terms under which universal service support will be available to ILECs and their competitors. Under that section, while states are required to designate more than one ETC in the areas served by non-rural carriers, in the areas served by rural telephone companies, states have the discretion to designate only one. Section 214(e) also requires that before designating an additional ETC in an area served by a rural telephone company, a state must find that the designation is in the public interest. If Congress did not believe that all of the carriers falling under its rural telephone company definition required this special consideration regarding CETC designations, it would have either established a different definition altogether, or established a more narrow definition just for the purposes of Section 214(e). However, it did not choose to do this and therefore neither should the Joint Board seek to substitute its own definition of "rural" for the singular definition established by Congress.

The Joint Board appears to be considering a different definition of "rural" for high-cost universal service purposes as a roundabout way in which to control the growth of the High-Cost program. If this is the case, it is a poor approach. Similar to the Joint

Board's recommendation to limit support to primary lines,[9] reducing the number of ILECs deemed to be "rural" for universal service purposes fails to directly address the primary cause of growth in the High-Cost program -- the funding going to CETCs in rural service areas as a result of the irrational identical support rule. If the Joint Board is seeking an effective and rational way to control the growth of the High-Cost program that is consistent with Section 254, then it should focus all of its resources on basing support for CETCs in rural service areas on their own costs rather than wasting time second-guessing Congress's definition of "rural telephone company."

Even if the Joint Board were to recommend truncating the statutory definition of "rural telephone company" for universal service purposes, it would not be very effective in reducing the size of the Fund. The fact is, the amount of support received by the largest rural telephone companies is relatively small. Of all the universal service support projected to be received by rural ILECs in 4th Quarter 2004 ($632.6 million), just 11 percent will be received by ILEC study areas with 100,000 access lines or more ($69.8 million).[10] Thus, the overwhelming majority of support for rural ILECs is going to smaller study areas with less than 100,000 access lines.

What this data reveals is that under a cost-based system of support, to the extent that larger rural carriers have lower per-line costs, the mechanism appropriately provides them with less support. For example, the Public Notice notes that Sprint Florida, a carrier with more than two million access lines, is self-certified as a rural carrier.[11] But what the Public Notice fails to mention is that Sprint Florida receives no support under the rural

[9] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 19 FCC Rcd 4257, 4279, ¶56 (2004) (Portability Recommended Decision).
[10] Universal Service Administrative Company, *Federal Universal Service Fund Size Projections for the Fourth Quarter 2004* (Aug 2, 2004), Appendices HC01, HC05, HC18.
[11] Public Notice, fn. 25.

High-Cost program.[12] Thus, a cost-based system already reflects any cost savings that may result from a larger carrier's economies of scale and scope.

Now, let us compare the division of support between larger and smaller rural ILECs to the division of support between larger and smaller CETCs. Of all the rural universal service support projected to be received by CETCs in 4th Quarter 2004 ($105.6 million), approximately 24 percent is earmarked for CETCs with 100,000 or more connections in a state ($25.3 million).[13] This is more than double the percentage of support going to rural ILEC study areas with 100,000 or more lines. This indicates that when CETCs are able to receive the ILEC's identical per-line support amount, with no accounting for their own economies of scale and scope, limited universal service resources are unnecessarily wasted. Therefore, there is no need to move a subset of rural telephone companies onto the non-rural universal service mechanism. Instead, the Joint Board should recommend that CETCs in rural service areas receive support based on their own costs, so that the same rationality built into the system for rural ILECs is applied to all ETCs in rural service areas.

Finally, the Joint Board should not attempt to pressure rural ILECs to consolidate through modifications in the universal service rules. The FCC's current universal service rules neither encourage nor discourage rural ILECs to consolidate, which is exactly how it should be. Forcing rural ILECs to consolidate would be bad for rural America.[14] Community-based rural ILECs help to keep skilled jobs in rural areas, thereby promoting rural economic development. There is also no evidence that consolidation would

[12] Sprint Florida does receive interstate access support. However, this is a result of its status as a price cap-regulated carrier and has nothing to do with its certification as a rural telephone company.
[13] Universal Service Administrative Company, *Federal Universal Service Fund Size Projections for the Fourth Quarter 2004* (Aug. 2, 2004), Appendices HC01, HC18.
[14] *See*, NTCA and OPASTCO Ex Parte, False Premises, False Conclusions: A Response to an Attack on Universal Service by Dale Lehman, RM 10822, CC Docket No. 96-45 (fil. Aug. 5, 2004), pp. 20-22.

improve the service quality in rural service areas. The Joint Board should continue to allow the marketplace to determine when and where consolidation will occur.

B. Support for rural ILECs should remain based on their embedded costs; support based on FLEC estimates would not be specific, predictable and sufficient and would threaten the continued provision of high-quality, modern service in rural service areas

The Public Notice asks whether a rural support mechanism that bases support on forward-looking economic cost (FLEC) estimates or on embedded costs more effectively achieves the Act's goals.[15] The answer, unequivocally, is embedded costs. The existing rural support mechanism based on embedded costs has been achieving the Act's universal service objectives. It has encouraged prudent network investment in high-cost rural areas. This, in turn, has resulted in the provision of quality services, including advanced services, that are reasonably comparable to those provided in urban areas and at reasonably comparable rates. The Joint Board should not tamper with a basis of support that is accomplishing what it is intended to do.

In particular, the existing support mechanism based on embedded costs has been instrumental to rural ILECs' ability to deploy the multi-functional infrastructure capable of providing advanced services. The deployment of facilities necessary to provide advanced services in rural areas is costly and risky. Most rural ILECs do not serve markets in which there is a strong business case for providing advanced services. A May 2004 survey of OPASTCO's membership found that the average penetration rate for advanced services among respondents was under 15 percent.[16]

The use of embedded costs in the rural support mechanism creates a direct link between the actual network investments made by rural ILECs and the support amounts

[15] Public Notice, ¶21.
[16] *See*, OPASTCO comments in GN Docket No. 04-54 (fil. May 10, 2004).

they receive. Without this link, rural carriers would be highly reluctant to make the network upgrades necessary to provide advanced services. Moreover, the increased risk created by a support system not tied to rural ILECs' actual embedded costs would make the capital markets far more wary about making financing available to rural carriers.

If universal service support was based on FLEC estimates, or some other method of calculating costs that did not relate to what rural ILECs actually invest in facilities, it would erect a substantial barrier to investment in the multi-use infrastructure capable of providing advanced services. As a result, the continued deployment of advanced services in rural ILEC territories would slow considerably. This would be entirely at odds with Sections 254 and 706 of the 1996 Act. It would also contradict the FCC's determination that its universal service policies should not create barriers to the provision of access to advanced services.[17]

For investment to occur, rural carriers must feel confident that the universal service mechanism will provide specific, predictable and sufficient support, as called for in Section 254(b)(5). This statutory objective would not be met under a mechanism based on FLEC. Support amounts would no longer be specific to carriers' own costs and circumstances. Carriers would be unable to predict what future manipulations to the FLEC model would have on their support, creating an unreasonable amount of uncertainty. And, if a FLEC-based mechanism resulted in less support than carriers receive today, it could very well be insufficient.

[17] Rural Task Force Order, 16 FCC Rcd 11322, ¶199 (2001). In addition, the FCC has declared that its primary policy goal is to encourage the ubiquitous availability of broadband to all Americans. *See, Appropriate Framework for Broadband Access to the Internet over Wireline Facilities; Universal Service Obligations of Broadband Providers; Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements*, CC Docket No. 02-33, CC Docket Nos. 95-20, 98-10, Notice of Proposed Rulemaking, 17 FCC Rcd 3019, 3021, ¶3 (2002).

Basing rural ILECs' support on FLEC estimates raises significant concerns, both theoretical and practical. To begin with, the FCC previously established that the technology assumed in any FLEC cost study or model "must be the least-cost, most efficient, and reasonable technology for providing the supported services that is currently being deployed."[18] In essence, what the Commission determined is that FLEC is to not reflect the network that actually exists and on which capital has been expended and needs to be recovered, but instead on a network that has no basis in reality. Economist Alfred Kahn has explained the cost recovery consequences that ILECs face under a methodology based on a hypothetical, completely new network, rather than the carrier's actual network:

> In a world of continuous technological progress, it would be irrational for firms to constantly update their facilities in order completely to incorporate today's lowest-cost technology, as though starting from scratch: investments made today, totally embodying today's most modern technology, would instantaneously be outdated tomorrow and, in consequence, never earn a return sufficient to justify the investments in the first place.[19]

Thus, a fundamental flaw with basing support amounts on FLEC is that it relies on a simplistic flash-cut to the latest technology to meet all demand. It fails to account for much of the cost already incurred in the build-out of a telecommunications system in areas that would likely not have quality service – or perhaps any service – if the marketplace alone had controlled the past development of the public switched network.

A least-cost, hyper-efficient network will never be constructed. This assumption is particularly unrealistic for a capital-intensive industry such as telecommunications, where network modernization is an evolutionary process. Furthermore, as competition

[18] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, 12 FCC Rcd 8776, 8913, ¶250 (1997) (Universal Service First Report and Order).
[19] Letter from Alfred F. Kahn to FCC Chairman Reed E. Hundt (Jan. 14, 1997).

grows in rural areas, it will fragment the demand among the carriers and their networks and further invalidate the FLEC model that is used.

Going beyond the inappropriateness of FLEC generally as the basis of universal service support for rural ILECs, there is the practical problem of developing a model that could consistently produce reasonable estimates of FLEC for all rural telephone companies, and account for the substantial diversity among them.[20] It has yet to be demonstrated that such a model can be produced.

In its thorough analysis of the FCC's synthesis model, the Rural Task Force found that when viewed on an individual rural wire center or individual rural carrier basis, the costs generated by the model were likely to vary widely from reasonable estimates of forward looking costs.[21] The Rural Task Force recognized that unlike the Bell companies who have the ability to "average out" discrepancies in the model's cost calculations, for rural carriers –

> the result of errors or radical changes in the amount of explicit support developed from a model which is imprecise at the company level could cause an individual carrier to either gain a substantial windfall or have a serious deficiency in "sufficient" support.[22]

A support mechanism based on FLEC would also not work congruently with rate-of-return regulation, under which most rural ILECs operate. Rate-of-return regulation provides carriers with the opportunity to recover their interstate-allocated embedded costs plus a reasonable return on investments, which have been made pursuant to a regulatory compact. Universal service support is one of the primary revenue streams

[20] *See, The Rural Difference*, Rural Task Force White Paper 2 (Jan. 2000), p. 26 ("…size differences among Rural Carriers, as well as the differences in the market and operations circumstances they face, are as critical as comparisons with the non-Rural Carriers.").
[21] *Rural Task Force Recommendation to the Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 16 FCC Rcd 6165, 6181 (2000) (Rural Task Force Recommendation).
[22] *A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, Rural Task Force White Paper 4 (Sept. 2000), p. 8.

in the interstate jurisdiction that enables rate-of-return ILECs to achieve full cost recovery for the provision of quality, ubiquitous service in high-cost rural areas. If a FLEC-based system were to reduce the level of support that rate-of-return rural ILECs received, it could result in confiscation of the ILEC's property unless another source of cost recovery was made available.

Several Joint Board members have rightfully expressed serious reservations regarding the use of FLEC as the basis of support for rural carriers. For instance, Commissioner Bob Rowe states that he "would not support imposing on smaller companies costing methodologies, or policies generally, that do not in my opinion always work terribly well even when applied to large companies." Commissioner Kevin Martin asserts that "we could better achieve sufficient universal service support and comparability of rates if we base our universal service support system on actual rather than forward looking costs." And Commissioner Jonathan Adelstein states that "[g]iven the significant questions documented by the Rural Task Force, I have serious concerns about [the FLEC model] approach."[23] OPASTCO strongly agrees with all of these statements.

Therefore, the Joint Board should recommend that universal service support for rural telephone companies continue to be based on their actual embedded costs. Substituting embedded costs with an unproven FLEC-based mechanism would only serve to threaten the continued provision of high-quality, modern communications services in rural service areas.

[23] Public Notice, Statement of Chairman Bob Rowe; Statement of Commissioner Kevin J. Martin; Statement of Commissioner Jonathan S. Adelstein. *See also*, Statement of Commissioner Kathleen Q. Abernathy ("Although a prior Commission embraced a forward-looking cost methodology for all carriers, we are launching this renewed inquiry to take a fresh look at the wisdom and feasibility of abandoning the embedded cost mechanism used to support rural telephone companies.").

C. Support for CETCs in rural service areas should be based on their own embedded costs in order to introduce rationality, accountability and competitive neutrality into the mechanism for these carriers

Support for CETCs in rural service areas should be based on their own embedded costs. There is no basis to presume that providing CETCs with the ILEC's identical per-line support amount will provide each CETC with "sufficient," but not excessive support, as called for by Section 254(b)(5) of the Act. In addition, Section 254(b)(5) provides that universal service support be "specific," but allowing CETCs to receive support based on the ILEC's costs is not at all specific to the CETC's own unique costs and circumstances.

When a CETC has lower costs than the ILEC, the identical support rule provides the CETC with an unfair competitive advantage. The fact that a CETC may have lower per-line costs than the ILEC with which it competes does not reflect inefficiency on the part of the ILEC, as wireless carriers and their representatives like to suggest. What it does reflect is the fact that ILECs and CETCs are not at all similarly situated. For instance:

- Competitive carriers are not required to provide ubiquitous service at the time of their request for ETC designation. Rural ILECs, as the recognized carriers of last resort in their service areas, have built ubiquitous, high-quality infrastructure that serves the most remote and highest-cost customers.

- CETCs can potentially be designated for a different, and sometimes significantly smaller service territory than the incumbent's study area. This makes it much easier for a competitive carrier to meet the Act's prerequisites for ETC designation.

- CETCs are typically not held to the same stringent service quality and reliability standards and customer billing requirements generally imposed on ILECs by state commissions. Consequently, while rural ILECs provide high-quality, reliable service, many wireless carriers are still offering what can only be considered a "best effort" service in rural areas.

- Rural ILECs have invested in their networks to accommodate increased demand for network capacity caused by longer holding times when customers connect to

> the Internet. As a result, customers pay nothing extra when they use their landline connection for Internet access. In contrast, Internet access over a mobile wireless connection, if available, is considered a premium service and customers typically pay an extra charge for the service.

In short, ILECs assume the full obligations of carriers of last resort, offering reliable, high-quality, facilities-based service to everyone in their service areas. CETCs, on the other hand, receive the ILEC's cost-based support, but with significantly fewer expectations and requirements placed on them. Clearly, this constitutes an unfair competitive advantage. It also creates arbitrage incentives for competitive carriers to seek ETC status in areas where they may not have otherwise, causing the size of the Fund to grow unnecessarily.

A recent decision by the District Court of Nemaha County, Kansas, confirms that providing CETCs with the ILEC's cost-based support is not competitively neutral. In *Bluestem Telephone Company, et. al. vs. Kansas Corporation Commission,* the Court overturned a decision by the Kansas Commission that made the state universal service support received by Kansas rural ILECs portable to competitors on a per-line basis. Like the federal rural high-cost mechanism, the state's support system is based on the ILEC's embedded costs. The District Court found that:

> The order of the [Kansas] Commission violates the [state's] statutory requirement to make distributions in a "competitively neutral manner," because the Commission has failed to evaluate all the necessary costs/expense information from all providers. The LEC's [sic] are different in structure and treatment as to rates then the wireless providers. Attempting to establish competitive neutrality without evaluating all providers' costs and expenses, means that the [Kansas] Commission has compared apples and oranges. In order that its orders are competitively neutral, the [Kansas] Commission must compare the same units of measurement.[24]

[24] In the District Court of Nemaha County, Kansas, *Bluestem Telephone Company, et. al vs. Kansas Corporation Commission*, Case Nos. 01-C-39, 01-C-40, 03-C-20, and 2004-CV-19, Memorandum Decision (rel. April 30, 2004), p. 10.

This decision makes clear that there is nothing competitively neutral about requiring rural ILECs to provide extensive data demonstrating above-average costs in order to qualify for support, while not requiring competitors to provide any cost justification for their own receipt of support. If the Joint Board wishes to adhere to the FCC's principle of competitive neutrality,[25] then it must recommend that the Commission immediately eliminate the identical support rule, and begin the process of basing CETCs' support on their own embedded costs.

Providing higher per-line support to the incumbent than to the CETC would not pose a regulatory barrier to competitive entry in rural areas. Mobile wireless providers sought after and obtained spectrum licenses for rural areas, either through auction or lottery, without any expectation of universal service support. These carriers have been successfully serving rural markets for many years now without any high-cost funding.

In the FCC's Ninth CMRS Competition Report, the Commission found that less densely populated counties (100 persons per square mile or less) have an average of 3.7 mobile competitors.[26] The FCC concluded that "CMRS providers are competing effectively in rural areas."[27] Therefore, basing CETCs' support on their own costs will not negatively affect their ability to compete in rural areas. All it will do is eliminate the perverse incentives that currently exist to seek ETC status merely to receive windfall support payments.

Basing CETCs' support on their own embedded costs would help to ensure compliance with Section 254(e) of the Act, which requires that support be used only for

[25] Universal Service First Report and Order, 12 FCC Rcd 8801, ¶47.
[26] *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services,* CC Docket No. 04-111, Ninth Report, FCC 04-216 (rel. Sept. 28, 2004), ¶109.
[27] *Id.*, ¶111.

the provision, maintenance and upgrading of facilities and services for which the support is intended. It is clear that the support rural ILECs receive has been used for its intended purposes since it is based almost entirely on their own past actual investment and expense payments, or reductions in other rates. However, it is nearly impossible to discern how competitors use the support they receive when it is based on the incumbent's actual spending record. If a carrier is going to receive limited high-cost funding, collected from the nation's ratepayers, then that carrier should be required to demonstrate above-average costs.

When CETCs are able to receive windfalls of support based on the ILEC's costs, it places unnecessary strain on the Fund. This threatens the High-Cost program's sustainability and the ability of all ETCs to receive sufficient support. A review of the most recent fund size projections from the Universal Service Administrative Company (USAC) validates the Joint Board's prior assertion that it is the CETCs that are driving the rapid growth in the rural High-Cost program.[28]

($Millions)	**4th Quarter 2003 Support**	**4th Quarter 2004 Support**	**% Change 4Q 2003 – 4Q 2004**	**Annual Support Increase**	**% of Total Annual Support Increase**
Rural High-Cost Support					
ILEC	$609.0	$632.6	3.9%	$23.6	29.5%
CETC	$49.3	$105.6	114.0%	$56.3	70.5%
Total	**$658.4**	**$738.2**	**12.1%**	**$79.8**	**100.0%**

Among other things, this chart illustrates that CETCs are responsible for approximately 70 percent of the annual growth in the rural portion of the High-Cost

[28] Portability Recommended Decision, 19 FCC Rcd 4285, ¶67 ("Much of this growth [in high-cost support] represents supported wireless connections that supplement, rather than replace, wireline service. Our examination of the record reveals the potential for uncontrolled growth as more and more competitive ETCs are designated in rural and high-cost areas.").

program, from 4th Quarter 2003 to 4th Quarter 2004.[29] It also shows that over the past year, the support going to CETCs in rural service areas has more than doubled.[30] It stands to reason, then, that the way to directly address the significant growth in the rural portion of the High-Cost program is to immediately abolish the identical support rule and move toward basing support for CETCs on their own costs. This would effectively eliminate the wasteful payout of windfall support amounts that threaten the Fund's viability while still ensuring that all ETCs receive sufficient support.

OPASTCO recommends that the Joint Board and/or FCC hold industry workshops to develop the accounting mechanisms through which CETCs in rural service areas would be required to report their embedded costs. A chart of accounts should be developed that is appropriate for CETCs in each industry segment (*i.e.*, wireless, wireline, etc.). The Joint Board and FCC should initially focus their attention on developing cost reporting rules for wireless CETCs since they presently receive more than 95 percent of the projected universal service support going to CETCs in rural service areas.[31]

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[29] Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2003* (Aug. 1, 2003), Appendix HC01; Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2004* (Aug. 2, 2004), Appendix HC01.

[30] The support amounts presented for CETCs reflect both existing CETCs as well as competitive carriers that have ETC applications that are pending. In the past, some wireless carriers and their representatives have argued that it is not appropriate to include support amounts attributable to carriers with pending ETC applications since they have yet to receive any support. However, USAC includes support amounts for yet-to-be-approved CETCs in its fund demand, which determines the contribution factor. Therefore, the inclusion of support amounts for pending CETCs is quite appropriate in this type of analysis, since it is reflected in the contributions that carriers are required to make today.

[31] Approximately $102.6 million, or 97 percent of fourth quarter 2004 projected universal service support payments for CETCs in rural service areas is going to wireless CETCs, with the remaining $3.1 million, or 3 percent, going to wireline CETCs. These figures are based on a conservative identification of known wireline vs. wireless CETCs listed on USAC's high-cost support projection summaries. *See*, Universal Service Administrative Company, *Federal Universal Service Support Mechanisms Fund Size Projections for the Fourth Quarter 2004* (Aug. 2, 2004), Appendix HC01.

Obviously, the specific types of costs reported by wireless ETCs and ETCs using other technology platforms will need to differ from the types of costs that LECs are required to report. However, the level of detail required from every ETC, regardless of technology, should be the same. There should be cost reporting parity between ILECs and CETCs. Cost studies should sufficiently rationalize a CETC's costs in a manner that approximates the results obtained by ILEC cost studies.

The Joint Board and Commission may also wish to consider developing an average schedule option for CETCs that would provide these carriers with a choice between submitting their own annual cost study or relying on formulas that would simulate the embedded costs of similarly situated carriers using the same technology. This would afford CETCs the same options as rural ILECs and give them the same opportunity to avoid the administrative costs of developing an annual cost study.

While OPASTCO recognizes that cost accounting mechanisms for CETCs will take some time to develop, that does not mean that the identical support rule should remain in effect until the new cost reporting rules are ready for implementation. During the period of time in which accounting rules are being developed, the Joint Board should recommend the adoption of the interim plan filed by the Rural Telecommunications Associations in the FCC's proceeding on the Joint Board's Portability Recommended Decision.[32] Under this plan, wireless CETCs would receive a "safe harbor" percentage of the rural ILEC's per-line support, with the specific percentage determined by the size of the wireless carrier. The percentages established in the plan are based on the relative cost

[32] *See*, Rural Telecommunications Associations comments in CC Docket No. 96-45 (fil. Aug. 6, 2004); Rural Telecommunications Associations reply comments in CC Docket No. 96-45 (fil. Sept. 20, 2004). The Rural Telecommunications Associations consist of OPASTCO, the Rural Independent Competitive Alliance (RICA), and the Rural Telecommunications Group (RTG).

differences between wireline and wireless carriers as they currently exist. The percentages also acknowledge the fact that large wireless carriers that serve predominantly metropolitan areas and most likely benefit from economies of scale require less support than smaller, mostly rural wireless carriers.

Wireless carriers should be permitted to have their support determined by the safe harbor percentages established in the Associations' plan up until a certain sunset date, to be determined by the FCC. This would give wireless CETCs a transition period to internally adopt the cost accounting procedures established for them.[33] After the sunset date, wireless CETCs would be required to adhere to the cost accounting rules (or use the average schedules) established for them in order to receive support. Similar transitionary measures and sunset dates should be established for wireline CETCs and CETCs utilizing other technology platforms.

Even though it may presently be difficult for some CETCs to demonstrate their costs, this is not a legitimate reason for exempting these carriers from having to perform cost studies in order to qualify for support. Carriers that seek public funding should be required to demonstrate that their costs are above average and exceed a certain threshold. Otherwise, the support they receive will most likely be more than just "sufficient," it will be excessive. The system needs to be accountable to those who ultimately fund it – ratepayers nationwide.

[33] *See*, Montana Public Service Commission reply comments in CC Docket No. 96-45 (fil. Sept. 22, 2004), p. 6 ("…the safe harbor will provide an administratively efficient solution, until such time as the Commission requires that all ETC's support be based upon their own costs.").

D. The existing support calculation methodology for rural ILECs should be maintained; basing support on statewide average costs would be extremely harmful to rural ILECs and their customers

The FCC should continue to calculate high-cost support for rural carriers based on individual carriers' study area average costs. The current rural universal service support mechanism has been achieving the goals of Section 254 of the 1996 Act. It provides appropriate incentives for investment in network facilities and functions used to provide the supported services. It would be imprudent to alter a support calculation methodology that is achieving its objectives.

Rural ILECs have strong incentives to operate as efficiently as possible, but those incentives are not impelled by the methodology for calculating universal service support. While universal service support is critical to rural ILECs' survival, it is not their only source of cost recovery. Rural ILECs operate in an increasingly competitive environment for a variety of telecommunications and information services. It is this competitive marketplace, and not universal service policy, that ultimately drives rural ILECs to operate efficiently.

Basing support on per-line costs does not create inefficiencies by increasing support when rural ILECs have declining line counts. The Joint Board must remember that rural carriers do not simply build lines, they build networks and it is these networks that enable carriers to provide the services supported by the High-Cost program. Although a rural ILEC's per-line support increases when its line count decreases, its total network support still remains the same. It is just being spread over fewer lines.

Major components of the costs of a rural ILEC's network are fixed and, within a reasonable range of output, do not go up or down significantly as individual lines are

added or disconnected by consumers. Also, in many states ILECs must maintain disconnected lines under carrier-of-last-resort obligations requiring them to reinstate service within a specified timeframe, and must provide E911 service to otherwise "disconnected" lines. These regulations further narrow the difference between maintaining a live or lost line. Thus, higher per-line support is necessary when line counts are declining in order to maintain sufficient support for the maintenance and upgrading of network facilities.

However, providing CETCs with the ILEC's identical per-line support is a highly inefficient use of limited public funding, particularly when the ILEC's per-line support amount is growing as a result of a declining line count. While it is essential for the ILEC to receive increased per-line support as its line count declines in order to avoid stranded costs and to meet state regulatory obligations, that increased per-line support translates into pure windfall in the hands of a CETC. That is yet another reason why the identical support rule should be abandoned immediately and CETCs' support be based upon their own costs.

The Commission should continue to use the authorized rate of return for the purpose of calculating universal service support for rural ILECs. As previously stated, most rural ILECs operate under rate-of-return regulation in the interstate jurisdiction. Universal service support, like access charges, is one of the interstate revenue streams that enable rate-of-return ILECs to achieve full cost recovery. It makes sense then that both of these cost recovery mechanisms should use the same rate of return. The Public Notice notes that in the MAG Order, the FCC maintained the authorized rate of return at

11.25 percent.[34] Therefore, the rate of return used in the universal service support calculation should also be maintained at 11.25 percent.

The calculation of support based on statewide average costs would be extremely detrimental to rural service areas, denying rural carriers sufficient support to provide high-quality service at affordable rates to their customers. OPASTCO estimates that if high-cost loop support (HCLS) payments were to be based on statewide average costs that include the costs of the non-rural carriers, it would reduce the HCLS available to rural carriers by more than 80 percent.[35] In addition, the Rural Task Force, in its recommendation to the Joint Board, found that 37 states, territories and protectorates which presently receive universal service support for rural carriers would see their support eliminated if statewide averaging were used in sizing the rural High-Cost program.[36] The Task Force assumed that policymakers would not likely adopt statewide cost-averaging for the rural carrier mechanism with this knowledge available to them.[37]

The Joint Board itself recognized in its October 2002 non-rural Recommended Decision that statewide averaging "may not be appropriate for the high-cost mechanism providing support to rural carriers."[38] The Joint Board correctly noted that "[m]any rural carriers lack the economies of scale and scope of the generally larger non-rural carriers, as the Rural Task Force established in documenting the differences that exist between rural and non-rural carriers."[39]

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[34] Public Notice, fn. 48 (citation omitted).
[35] Based on the National Exchange Carrier Association's (NECA) 2004 submission of 2003 USF Data Collection Study Results.
[36] Rural Task Force Recommendation, 16 FCC Rcd 6162.
[37] *Id.*
[38] *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Recommended Decision, 17 FCC Rcd 20716, 20728, ¶28 (2002).
[39] *Id.*

Indeed, unlike the non-rural carriers, rural telephone companies do not have large, low-cost metropolitan cores that they can use to offset the high cost of their sparsely populated rural territories. Consequently, basing support on statewide average costs would seriously hinder rural carriers' ability to continue investing in infrastructure, and would produce services and rates that were no longer reasonably comparable to those offered in urban areas. In some cases, drastic increases in local rates could be necessary, making basic service unaffordable for some consumers. In other words, the results of statewide averaging for rural carriers would be the complete antithesis of the statutory objectives of universal service.

In addition, many federal legislators are not pleased with the results of statewide averaging, even for the non-rural carriers. There are bills currently pending in Congress – H.R. 1582 in the House of Representatives and S. 1380 in the Senate – that seek to remedy the perceived inequities that statewide averaging has created in the non-rural High-Cost program. In particular, H.R. 1582 finds that "[c]alculating Federal universal service support exclusively on a statewide average basis improperly places responsibility on most State governments to support high cost areas with minimal assistance from the Federal Government." Both bills have substantial bipartisan support. The Joint Board should not recommend the use of statewide average costs to calculate support for rural carriers when numerous representatives and senators believe it was a mistake even for the non-rural carriers. Support for rural carriers should remain based on individual carriers' study area average costs.

After seeking comment on calculating support using statewide average costs, the Joint Board asks whether rural company support should be based on wire center costs

in order to more effectively target support to rural carriers.[40] This is neither necessary nor desirable. The only reason that it was necessary to permit rural ILECs to disaggregate and target their support below the study area level was because of the illogical portability rules which base CETCs' support on the ILEC's costs. If support for CETCs was based on their own costs, there would no longer be any need to target ILECs' support below the study area level. Also, as the Joint Board correctly notes, it would be administratively burdensome to calculate embedded costs at the wire center level since rural ILECs calculate and submit their costs at the study area level.[41] Thus, the study area is the smallest area on which it is reasonably feasible to base rural ILECs' support.

The existing local switching support (LSS) mechanism works well and should remain in place. The LSS mechanism recognizes that small ILECs have a limited base of customers over which to spread the costs of switch upgrades. Even though eligibility for LSS is determined by an ILEC's number of lines in service, the mechanism is still responsive to costs. To the extent that a small ILEC's switching costs are declining, the amount that the carrier receives from LSS also decreases because fewer dollars are assigned to the interstate jurisdiction.

There continues to be a need to provide small carriers with support for high switching costs. While it may be true that switching costs are generally declining for all carriers, small rural LECs will continue to have higher switching costs on a per-subscriber basis than their large, urban carrier counterparts. Therefore, targeted switching support is necessary to continue to encourage prudent upgrades in switching equipment and to help ensure that services and rates in the areas served by small carriers

[40] Public Notice, ¶45.
[41] *Id.*

remain reasonably comparable to those available in urban areas of the country. Again, to the extent that switching costs are falling, the LSS that small ILECs receive will also decline under the existing calculation methodology.

It should be noted that the current portability rules allow large CETCs to receive LSS that they clearly do not need. A large wireless CETC serving throughout a state may only need one switch to serve all of the customers within that state. Thus, they have the economies of scale that the small ILECs lack. Yet, under the existing rules, a large wireless CETC still receives LSS in each of the small ILEC service areas in which it has been designated. The LSS mechanism was not intended to provide large carriers with support. Moreover, it is not competitively neutral that these carriers can receive LSS while ILEC study areas with more than 50,000 lines cannot. Basing CETCs' support on their own costs would eliminate this problem.

The existing support mechanisms for rural carriers should not be consolidated into a single mechanism. Each serves a separate and distinct purpose. HCLS offsets high intrastate loop costs by transferring a portion of those costs to the interstate jurisdiction. It enables local rates and services in rural areas to be affordable and reasonably comparable to those offered in urban areas. Interstate common line support (ICLS) recovers interstate loop costs previously recovered through the carrier common line access charge. It is intended to facilitate comparable interexchange service options in high-cost rural areas. LSS recognizes that small ILECs have higher switching costs on a per-subscriber basis than large carriers and allows them to assign a greater portion of those costs to the interstate jurisdiction. It helps encourage the deployment of modern switching equipment in rural areas.

The FCC recently took another support mechanism, long term support (LTS), and merged it into ICLS.[42] This made sense because the two mechanisms served essentially the same purpose. The remaining mechanisms, however, all serve different purposes.

In addition, LSS provides a jurisdictional shift in revenue requirement from state to interstate for recovery and is used as an offset to traffic sensitive interstate access charges. If LSS was consolidated with other support mechanisms, the FCC would then have to develop a process that would enable NECA, as well as individual small ILECs that file their own traffic sensitive switched access tariffs, to properly account for switching support in the access rate development process. Therefore, further consolidation of the support mechanisms would not be appropriate.

III. THE JOINT BOARD SHOULD CONSIDER THE POTENTIAL OUTCOMES OF OTHER INTERRELATED PROCEEDINGS BEFORE RECOMMENDING ANY CHANGES TO THE SUPPORT MECHANISM FOR RURAL ILECS

As the Joint Board contemplates changes to the universal service support mechanism for rural ILECs, it should not do so in isolation. It should also consider the potential outcomes of other open proceedings that are highly interrelated to the issues currently before the Joint Board. For instance, there is an open proceeding on intercarrier compensation reform in which the FCC is contemplating moving closer to a bill-and-keep regime.[43] Over the past few months this proceeding has "heated up" again as several

[42] *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order and Second Further Notice of Proposed Rulemaking, 19 FCC Rcd 4122, 4146-4153, ¶¶54-67 (2004).
[43] *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001).

industry groups have filed intercarrier compensation reform plans with the Commission.[44]

Rate-of-return regulated rural ILECs recover a very significant portion of their interstate revenue requirement through universal service support and interstate access charges. The revenues that rural ILECs presently receive from these sources enables them to provide service that is affordable and reasonably comparable to urban areas of the country, while still achieving full cost recovery.

Rural ILECs' worst fear is that intercarrier compensation reform will significantly reduce or eliminate the revenues they receive from access charges and that they will not be provided with another cost recovery mechanism, other than their limited number of subscribers, to make up the shortfall. If rural ILECs do not feel confident that they will have the opportunity to recover their costs in a manner that does not place all of the onus on their subscribers, they will not make prudent network investments, and rural consumers will be left behind. Given the cloud of uncertainty that hangs over the future of intercarrier compensation, it would be unwise for the Joint Board to recommend changes in the rules on universal service support for rural ILECs, particularly when there is nothing to indicate that universal service reform is needed for these carriers.

In addition to intercarrier compensation reform, the FCC also has an open proceeding on the USF contribution methodology.[45] If done properly, reform of the

[44] *See*, Expanded Portland Group ex parte, CC Docket No. 01-92 (fil. May 12, 2004); Alliance for Rational Intercarrier Compensation ex parte, CC Docket No. 01-92 (fil. June 9, 2004); Intercarrier Compensation Forum ex parte, CC Docket No. 01-92 (fil. Oct. 5, 2004).

[45] *See, for example, Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *1998 Biennial Regulatory Review – Streamlined Contributor Reporting Requirements Associated with Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms*, CC Docket No. 98-171, *Telecommunications Services for Individuals with Hearing and Speech Disability, and the Americans with Disabilities Act of 1990*, CC Docket No. 90-571, *Administration of the North American Numbering Plan and North American*

contribution methodology would alleviate some of the strain on the High-Cost program. The Joint Board has previously recommended that Congress amend Section 254 to provide the FCC with the authority to assess total telecommunications revenues, intrastate as well as interstate.[46] OPASTCO supports this recommendation. A total revenues assessment would address the marketplace factors that are causing instability in the contribution base and significantly lower the contribution factor.

In addition to the use of total revenues, the Joint Board should also encourage the Commission to require all facilities-based broadband Internet access providers over all technology platforms to contribute to universal service. This would help keep the Fund sustainable for the long term as increasing amounts of network traffic migrate to broadband platforms. It would also establish competitive neutrality as digital subscriber line (DSL) providers are currently required to contribute but other broadband platforms such as cable modem are not. Effective reform of the contribution methodology, along with reform of the basis of support for CETCs, should eliminate any perceived need to alter the universal service mechanism for rural ILECs in a manner that would threaten the provision of high-quality, affordable service in rural areas.

Numbering Plan Cost Recovery Contribution Factor and Fund Size, CC Docket No. 92-237, NSD No. L-00-72, *Numbering Resource Optimization*, CC Docket No. 99-200, *Telephone Number Portability*, CC Docket No. 95-116, Notice of Proposed Rulemaking, 16 FCC Rcd 9892 (2001).

[46] *See*, letter from state members of the Federal-State Joint Board on Universal Service to Marlene Dortch, Secretary, CC Docket No. 96-45, Second Ex-Parte Recommendation on Universal Service Contribution Mechanism (fil. May 20, 2003), p. 3 (citing letter from Federal-State Joint Board on Universal Service to Senator Conrad Burns, May 19, 2003).

IV. CONCLUSION

The Joint Board should recommend that the universal service support mechanism for rural telephone companies remain as it is today. The mechanism -- based on study area average embedded costs -- is rational, accountable to the public and achieves the universal service goals of the 1996 Act. It also provides the appropriate incentives for ILECs to invest in their networks so that rural consumers have access to high-quality services, including advanced services, that are reasonably comparable to those available in urban areas and at reasonably comparable rates. Altering the support mechanism for rural ILECs would only serve to threaten the continued achievement of the universal service objectives established by Congress.

On the other hand, the current basis of support for CETCs is in serious need of reform. Providing CETCs with the ILEC's identical per-line support has enabled these carriers to receive support that exceeds their costs, and that exceeds "sufficiency." The identical support rule is not competitively neutral and provides CETCs with an unfair competitive advantage. It has also been the primary cause of significant growth in the rural High-Cost program in recent years, and unnecessarily jeopardizes the program's sustainability.

The Joint Board should therefore recommend that the identical support rule be immediately eliminated and that CETCs in rural service areas be transitioned to a system of support based on their own embedded costs. By basing support for CETCs on their own costs, it would establish the same rationality and accountability in the support mechanism for these carriers that already exists in the mechanism for rural ILECs. It

would also better ensure that all ETCs continue to be able to receive sufficient support for the provision of quality services to high-cost rural consumers.

Respectfully submitted,

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October 15, 2004

CERTIFICATE OF SERVICE

I, Jeffrey W. Smith, hereby certify that a copy of the comments of the Rural Telecommunications Associations was sent by first class United States mail, postage prepaid, on this, the 15th day of October, 2004, to those listed on the attached list.

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